Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier	)	CC Docket No. 01-92
Compensation Regime	)	

REPLY COMMENTS OF
ACS OF ANCHORAGE, INC.

Submitted by:

ACS of ANCHORAGE, INC.

Wesley E. Carson
President & Chief Administrative Officer
510 L street, Suite 500
Anchorage, Alaska 99501

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<u>Summary</u>

In reviewing the Comments filed by other parties in this proceeding, ACS has noted several specific matters which warrant additional discussion in reply, including:

◊ It is essential that consistent cost definitions be applied between the federal and state jurisdictions in order to avoid problems of arbitrage, confiscation, and disincentives to investment;

◊ ACS' specific experiences in the Anchorage market confirm that if the jurisdictions cannot come to a mutual agreement on this issue, the Commission should exercise the tools available to it under the Act to engender conformity between federal and state jurisdictions;

◊ To the extent intercarrier compensation reform proceeds, it should account for and build upon the current Commission proceedings (including MAG) addressing access charge reform for non-price cap companies like ACS; and

◊ Reduced regulatory intrusion and greater reliance on market forces should be specifically integrated into any proposed new regime for intercarrier compensation.

ACS believes adherence to these precepts will promote the Commission's goals in this proceeding, as well as Congressional goals in the 1996 Act for a "pro-competitive, deregulatory national policy framework."

Introduction

In its initial Comments in this proceeding, ACS of Anchorage (ACS)[1] addressed a number of issues raised in the Commission's Notice of Proposed Rulemaking.[2] Among other matters, ACS noted that –

◊ The continuing inconsistency of cost definitions, between and within the state and federal jurisdictions, lends itself to the kind of uneconomic arbitrage possibilities occasioning the Commission inquiry in this proceeding;

◊ Changes in intercarrier compensation which extend to the existing access charge regime for non-price cap companies hold significant, potentially adverse consequences for universal service and for facilities investment. This is particularly true for Alaska, where telecommunications has historically depended upon access to outside support (implicit and explicit); and

◊ The competitive context attending this rulemaking (ACS' Anchorage market, as an example, is among the most competitive in the nation) warrants affirmative measures to reduce and eliminate, where practicable, regulatory intervention in the marketplace.

In reviewing the Comments submitted by other parties and, further, in light of impending developments with respect to the Multi-Association Group (MAG) proposal now before the Commission,[3] ACS believes additional development of these issues is appropriate in the reply portion of this proceeding.

Accordingly, ACS proposes to amplify the following points in its Reply:

◊ Consistency in cost definition and consistent application between the federal and state jurisdictions is essential to avoid problems of arbitrage, confiscation, and disincentives to investment;

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[1] ACS of Anchorage is owned in common with other ILEC, wireless, and Internet service providers, as identified in its Comments, by Alaska Communications Systems Group, Inc., a publicly traded company (NASDAQ: ALSK).

[2] *In the Matter of Developing a Unified Intercarrier Compensation Regime,* CC Docket No. 01-92, Notice of Proposed Rulemaking, (rel. April 27, 2001) at ¶ 133 ("Notice").

[3] *See Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Notice of Proposed Rulemaking, FCC 00-448 (released January 5, 2001).

◊ ACS' specific experiences confirm that if the jurisdictions cannot come to a mutual agreement on this issue, the Commission should exercise the tools available to it under the Act to engender compliance by the states;

◊ To the extent intercarrier compensation reform proceeds, it should account for and build upon the current Commission proceedings addressing access charge reform for non-price cap companies like ACS; and

◊ Reduced regulatory intrusion and greater reliance on market forces should be specifically integrated into any proposed new regime for intercarrier compensation.

In furtherance of these points, ACS offers the following reply comments.

1. Federal and state cost definitions must be congruent to the greatest practicable degree, in order to avoid regulatory arbitrage and other adverse public interest consequences.

The Notice demonstrates the necessity of uniform cost methodologies and definitions in response to its own question, "What is the appropriate cost methodology?":

> <u>The introduction of competition and new technologies appears to be exacerbating regulatory arbitrage opportunities, which suggest that we need to move quickly to a single cost methodology for setting both access charges and reciprocal compensation rates.</u> To the extent we need to adopt a uniform methodology other than bill and keep, we believe that…we should adopt a forward-looking cost methodology…. We also seek comment on <u>whether, in order to achieve the benefits of a uniform intercarrier compensation regime, state public utility commissions would need to move intrastate access charges to forward-looking costs</u>.[4]

As this inquiry recognizes, uneconomic arbitrage can arise from inconsistencies in the way costs are defined, both within one jurisdiction and as between jurisdictions. Where the state and federal jurisdictions employ different definitions of carrier costs, non-incumbent service providers may be incentivized to exploit any artificial advantages created, such as by mischaracterizing the jurisdictional nature of traffic (intrastate v. interstate) or by misidentifying their status (end-user v. network). These uneconomic incentives may be further exacerbated by

[4] Notice at ¶ 99.

divergences in the structures applied to recovery of those costs. For example, federal imposition of bill-and-keep for reciprocal compensation and access, but state retention of per-minute access charge structures, could promote mischaracterization of traffic to avoid the residual per minute costs of the latter.

Divergent cost definitions generate regulatory-generated problems no different from those the Commission has articulated in related proceedings. They encourage contestants in the competitive marketplace to make decisions which, but for the regulatory disparities, would make no economic sense. Such decisions misallocate and waste finite resources, and thus disserve the public interest. For these reasons, the Commission has already moved to correct certain aspects of intercarrier compensation dealing with ISP-bound traffic and CLEC terminating access. [5]

There are other potential problems, as well. On a carrier's financial books, the costs and investments must add up to "1" (especially if it is a publicly traded company). If all regulatory jurisdictional cost definitions similarly do not add up to "1," then consumers may ultimately pay too much (double recovery of some elements of costs and investment), or carriers may receive too little (under-recovery). If costs and investment recognized by regulators for recovery equate to only a percentage of actual investment costs, then application of a nominally adequate rate of return will result in a factually inadequate return. If the actual return sinks below "0," the result is confiscation, whereby the carrier's past investment is taken without just compensation.

The old canard that "ILECs are not guaranteed adequate earnings or rates of return" is an irrelevant response here. The divergent cost definitions at work, described above, guarantee the

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[5] *See In the Matter of Intercarrier Compensation for ISP-Bound Traffic,* CC Docket No. 99-68, Order on Remand and Report and Order (rel. April 27, 2001)("*ISP-Bound Compensation Order"*); *and see In the Matter of Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers,* CC Docket No. 96-262, Seventh Report and Order, FCC 01-146 (rel. April 27, 2001) ("*CLEC Access Charge Order"*).

obverse, that incumbent carriers will not achieve adequate earnings. Worse, under recovery of past investments discourages future investments. If financial markets perceive that incumbent carriers have no realistic chance of reasonable returns on investment, they will take their money elsewhere. There is no such thing as an "investor-of-last-resort" obligation. Because they can deprive the service provider of both the ability and the incentive to make future investments, inconsistent cost methodologies adversely impact infrastructure investment, past and future.

ACS notes that these concerns are not mere speculation, but represent the continuing experience of ACS in the Anchorage market. That market, as ACS has previously noted, is probably the most competitive local exchange market in the country.[6] Under the provisions of Section 252, the state commission has previously established interconnection and unbundled network element rates for ACS's competitors to use in competing for Anchorage end-users business. The commission is also currently setting ACS' end-user rates and access charges, including rates for basic residential and business service in the Anchorage marketplace. In so doing, the agency has used an unauthorized version of FLEC for UNE pricing, but is concurrently applying a state-required book or embedded cost basis (wholly unrelated to the FLEC standard) to establish local end-user rates. ACS, thus, is selling inputs to competitors on one cost definitional basis and contemporaneously competing against that competitor for the same end-user on the basis of regulated retail rates set on a different cost basis. This disparity results in the problems described in prior pleadings –arbitrage, confiscation, and disincentives to investment.

[6] Within the past month, additional market entrants have indicated their intent to compete in Anchorage, which already has three major competitive entrants who, in the aggregate, have secured a 41% share of the local market.

In the Anchorage market, this condition is further worsened by the failure of the state agency to apply the proper FLEC standard. The approved UNE rates do not reflect the forward looking costs of ACS under either the Commission's Local Competition standards[7] or under the *Iowa Utilities II*[8] decision. Instead, the state agency required use of the FCC default pricing schedules which were based upon and reflect the cost of the former Bell Operating Companies. This use of the FCC synthesis model for pricing unbundled network elements occurred notwithstanding the FCC's clear warning that the model was not intended for use in pricing UNEs.[9]

The RCA then compounded this error by utilizing the model's defaults for most of the cost inputs, rather than using ACS-specific forward-looking inputs. The costs presented by ACS were the lowest cost for network construction achievable in Alaska. The costs were based on competitive bids and supported by contractual commitments going forward, but were rejected based upon a misapplication of FCC rules. Some examples of this misapplication are:

	ACS FLEC	HCPM Default	% of FLEC Cost recovered
Man-hole			
2-duct capacity	$ 5,318	$ 1,436	27 %
9-duct capacity	$ 11,952	$ 5,176	43 %
Duct cost per kilo-foot	$ 6,787	$ 720	11 %
NID cost	$ 89	$ 27	30 %
Drop cost per kilo-foot	$ 2,840	$ 560	20 %
Digital Loop Carrier			
Fixed cost per 2016 f.o. terminal	$236,143	$ 152,617	65 %
Fixed cost per 24 f.o. terminal	$ 28,581	$ 19,881	70 %

[7] *See In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* First Report and Order, CC Docket No. 96-98, 11 FCC Rcd 15499 (1996) at ¶ 685: UNE pricing must reflect "costs that incumbents actually expect to incur in making network elements available to new entrants."

[8] *Iowa Utilities Board v. Federal Communications Commission, et al.*, 219 F.3d 744 (8th Cir. July 18, 2000) ("*Iowa II*").

[9] *See, e.g., Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Report and Order, at ¶32.

24 Gauge Copper Buried Cable $/ft.			
200 pair	$ 5.85	$ 2.63	45 %
900 pair	$ 15.43	$ 9.51	62 %
1800 pair	$ 27.19	$ 18.37	68 %
2400 pair	$ 35.24	$ 24.27	69 %

This failure to properly price UNEs, problematic in its own context,[10] has direct consequences in the intercarrier compensation context, as well. UNE rates represent yet another form of the carrier-to-carrier payments, liable to the arbitrage problems previously identified by the Commission. They are carrier-to-carrier because CLECs in the Anchorage market pay unbundled network element rates to ACS, an ILEC. Where these CLECs compete with ACS for the same end-user consumers, these CLECs --

> … have every incentive to compete, not on [the] basis of quality and efficiency, but on the basis of their ability to shift costs to other carriers, a troubling distortion that prevents market forces from distributing limited investment resources to their most efficient uses.[11]

The underpricing of ACS UNE rates in the Anchorage market represents just such a situation, because the substantial under-recognition of costs and resulting under-recovery of investment exacerbate the regulatory arbitrage problems described by the Commission in its Notice. Because ACS' local and access charge rates are set on the basis of book or embedded costs, but its unbundled network element prices on average BOC forward looking economic costs, it competitors can arbitrage divergences in those rates when competing against ACS for the same end-user in the same market.

[10] ACS has sought separate judicial review of the agency determinations described in this pleading, which unfortunately has been stalled by the State commission's insistence on sovereign immunity from federal court jurisdiction. ACS is not seeking collateral review of those determinations here, but rather is suggesting reasons why Commission action to engender consistent cost definitions among the jurisdictions is essential to securing its policy and public interest goals.

[11] ISP-Bound Compensation Order at ¶ 21.

It is essential that a way be found to remove or minimize this cost definitional disparity. Merely adjusting federal intercarrier compensation, without also rectifying the disparities on the state side, will not achieve the Commission's public interest goal for such compensation reform. The Commission should investigate a course by which the states will consistently follow the Commission's rules, lest the Commission's goals be frustrated by divergent state regulatory conduct.

2. The Commission should exercise its authority to reduce cross-jurisdiction disparities in cost definition and cost recovery structures.

As the Notice suggests, the Communications Act, as amended, provides several sources of authority for establishing intercarrier compensation rates and methodologies. Key among them are those found in Section 201 *et seq*., which gives the Commission basic power over access charges; Section 10, which authorizes and requires the Commission to forbear from enforcing rules determined (under a three-part test) to no longer be necessary to protect the public interest; Section 253, which prohibits states from erecting impediments to the provisioning of telecommunications services; and Section 410, governing jurisdictional separations. The matter is a complex one and, as the Commission has carefully acknowledged, entails matters of comity that run in parallel with statutory considerations:

> As previously indicated, this Commission and the state public utility commissions have long shared the responsibility for regulating intercarrier compensation. Furthermore, this Commission has always strived to cooperate with the states to carry out this dual responsibility.[12]

[12] Notice at ¶ 122.

Such cooperation will remain necessary to the effective and timely resolution of this problem. Nonetheless, a few examples of possible Commission initiative can be given, suggesting that consistency could be achieved under Commission leadership.

Altering the current balance of jurisdictional separations allocations offers one such potential. Transferring to the federal jurisdiction revenue requirements currently allocated by the states to intrastate access would be possible under Section 410 of the Act. As so transferred, these costs (including their definition and structure for recovery) would be subject to Commission jurisdiction under Section 201 *et seq*. of the Act. The Commission could then proceed with its current efforts at reform in various related proceedings, including this one.

In the case of ACS, this would include completing the current phase of non-price cap company access charge reform in connection with the MAG proposal.[13] Implicit subsidies would need to be removed from such charges and placed in an appropriate universal service fund. Thereafter, the Commission could adopt the appropriate intercarrier compensation regime (broadly, as reflected in the Notice, bill-and-keep or a reformed CPNC regime) and enforce the same under its existing statutory powers.[14]

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[13] Notice at ¶ 97, n.156.

[14] ACS notes that this approach may have independent value in solving the unique access charge, universal service, and intercarrier compensation issues presented in Alaska. The total Alaska annual, intrastate access charge requirement is approximately $49 million, of which about $35.8 million is associated with the common line. ACS believes much of this amount represents implicit subsidies being generated to maintain affordable end-user rates in a state with scarcely one person per square mile. This sum, if redistributed in a state SLC, would amount to an additional burden of about $90.00, annually. Transfer of this requirement to a national universal service fund, however, would impose no material burden on telecommunications users nationally. It would also offset the costs which Alaskan consumers pay as a result of the Commission's adoption of the CALLS proposal. Since Alaska is served by none of the price cap ILECs involved in that plan, the $650 million universal service fund created by CALLS does not benefit Alaska. Alaskans, however, do pay incrementally higher universal service costs in support of that fund, notwithstanding that absence of benefit.

A second conceptual alternative arises from the prohibitions set out in Section 253 of the Act. The proper definition of forward looking costs, under either *Iowa Utilities II* or the prior Commission pronouncement in the Local Competition proceedings, focuses on the forward looking costs of the specific carrier for whom interconnection rates are being established. *Iowa Utilities I*[15] has established the general power of the Commission to promulgate interconnection rules, particularly with respect to pricing matters. The Commission could clarify its existing rules to add specificity with respect to how FLEC is to be defined in all interconnection proceedings, including reciprocal compensation, access, and unbundled network element issues. That rule would provide guidance to the states, which the FCC could make binding under Section 253's power to pre-empt state rules contrary to the statute's requirements. The practical effect would be to substantially reduce the disparity between jurisdictions of cost definitional methodologies, consistent with section 201, 252, and 253 of the Act.

Neither of these examples is without problem. They each suggest, however, that legal avenues exist for the practical resolution of the current inconsistencies in cost definition. They also respond to the Commission's concern for ensuring harmony in state and federal attainment and application of consistent rules.

3. Any intercarrier compensation reform should account for and build on the current Commission proceedings directed to access charge reform for non-price cap companies like ACS.

ACS joins the other parties and state commissions who have described and cautioned against the severe and adverse effects on universal service which any intercarrier compensation reform (and especially bill-and-keep) poses. Access charges, as ACS and others have repeatedly

[15] *AT&T v. Iowa Utilities Board,* 525 U.S. 366 (1999).

affirmed, are significant sources of revenue for smaller, non-BOC companies. This is particularly the case with respect to incumbent carriers serving Alaska. As noted in the preceding section, large shifts in cost burdens now borne by interexchange carriers via access charges could increase basic end-user rates considerably. The way to solve problems of economic efficiency, uneconomic arbitrage, and terminating monopolies is not merely (and literally) to pass the buck to the end-using consumer.

Before such changes are effected, non-price cap company access charges need to be scrubbed for implicit subsidies, and those subsidies need to be converted to necessary, predictable, and sufficient levels of universal service funding. The Commission has already acted positively with respect to rural telephone carriers in adopting major elements of the Rural Task Force recommendations. The Commission, further, has recently announced initiatives with respect to the MAG proposal and non-price cap company access charge reform. These should be permitted to proceed to their conclusion before further intercarrier compensation changes are authored in this proceeding.

Additionally, any such changes must be accompanied by transitional mechanisms to ensure that the proposed cure does not generate new and greater ills for carriers and consumers, alike. The Commission's implementation of price cap company access charge changes in CALLS and of universal service reform for rural carriers under the RTC recommendations reflect an appropriate recognition of the need to implement changes slowly. In this regard, ACS concurs in the recently expressed view of the Chairman in this proceeding that:

> In closing, I would note that these actions, which are the products of intense and long discussions and which will take years to implement, are hardly precipitous.[16]

[16] Notice, Separate Statement of Chairman Michael K. Powell at 67 (emphasis added).

Reform is needed to cure the problems of regulatory arbitrage, but precipitous attempts may only make matters worse.

4. Reduced regulatory intrusion and greater reliance on market forces should be specifically integrated into any proposed new regime for intercarrier compensation.

ACS agrees with the Commission's views concerning reduced regulatory intervention:

> It also seems appropriate to consider the degree of regulatory intervention required to implement various interconnection regimes. Some regimes require extensive regulatory intervention, while others are more market-oriented and thus largely self-administering. Market-oriented solutions may provide more timely adjustments and avoid distortions resulting from incorrect or outdated regulatory decisions.[17]

Competitive markets by definition rely upon competition. In the long haul, competition and regulation are inherently antithetical: the more agencies intrude, the less freedom market participants have. ACS urges the Commission to promote reduced regulation, both in any final market structure envisioned by this rulemaking and equally in the transitional mechanisms leading to that structure.

Among the options for such reduction, ACS would note the following. The Commission could provide for sunset provisions to terminate requirements no longer necessary after a reasonable transition period. This would follow the example of Congress in adopting such sunset provisions with respect to various transitional requirements imposed on BOCs under Section 272 of the Act. The Commission could also provide for deaveraging of rates and bundling of service after threshold requirements, such as entry by a competitor, are met. Consistent with prior Commission determinations, such relaxation would promote adjustment to competitive conditions by all market participants, in an equitable and gradual way.

[17] *Id.* at ¶ 34.

ACS would recommend against threshold tests based upon loss of market share. Although ACS would likely meet now any reasonable test with respect to the Anchorage market (given its loss of over 40% of market share there), it believes that the imposition of such one-dimensional tests continues to misdirect focus on the actions of competitors, instead of properly focusing attention on the objective conditions of competition in the marketplace. The former course surrenders control to the business plans and manipulations of competitors – the very problems which have necessitated this proceeding. The latter course serves the public interest by establishing fair and neutral rules for competitive activity and by minimizing the need for ongoing regulatory intervention. This result is fully consistent with the Commission's objectives in this proceeding.

Conclusion

There is a clear need for conformity in intercarrier compensation rules and for consistent application in both state and federal jurisdictions. The application of forward looking cost definitions concurrently with book cost methodologies for intercarrier rates of all kinds – reciprocal compensation, access, and unbundled network elements – creates opportunities for regulatory arbitrage in each, and across both, jurisdictions. State agency misinterpretation of and misapplication of FCC defaults in developing forward-looking costs for ACS shows the manner in and degree to which this arbitrage can be exacerbated. The consequences for the public interest are severe. ACS has been compelled to follow a conservative course for facilities investment in some of its serving areas. And because of the arbitrage at work in its markets, ACS' competitors are not incentivized to and do not invest in their own facilities, leaving the public the worse off. The Commission in this proceeding can correct this situation by assaying and establishing a consistent intercarrier compensation regime between and among the state and federal jurisdictions.

Respectfully submitted,

ACS OF ANCHORAGE, INC.

Wesley E. Carson
President & Chief Administrative Officer
510 L Street, Suite 500
Anchorage, Alaska 99501

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